68-10

CA2ON
Z 1
-63A22

JAN 30 1964

Brief to the Ontario Committee on Taxation

on the matter of
Security Transfer Tax

Submitted
January, 1964, by

The Investment Dealers' Association of Canada

Recommendation

The Investment Dealers' Association of Canada requests that careful consideration be given to the following recommendations:

1. that the Security Transfer Tax Act be rescinded,

   or, in the event that this is considered to be impractical at the present time,

2. (a) that the Security Transfer Tax Act, regulations and rulings be amended, consolidated and re-written as soon as possible to reflect the major changes which have taken place in the investment industry;

   (b) and that the discretionary power now provided for in Section 14 of the Security Transfer Tax Act be used to issue a regulation eliminating double taxation;

   (c) and that regulations, departmental rulings and interpretations made in connection with the Security Transfer Tax Act be regularly promulgated to The Investment Dealers' Association of Canada so that it can advise its Members.

Statement of the Problems

The Investment Dealers' Association of Canada supports the principle that in a free economy the prime purpose of taxation is to raise revenue to provide for essential government expenditures in a manner that is fair, equitable and non-discriminatory, and in a manner that has the least effect on incentives and least restricts the growth of the economy. In addition to its ability to produce according to this principle, the total collection cost of a good tax should be small.

In our opinion the Security Transfer Tax does not satisfy these requirements. The small total return of the tax places it in what may be termed as the "nuisance group". The collection costs are largely borne by the investment industry and these are high. We do not believe that this special tax which affects investors and the investment industry is fair and equitable. Furthermore, the tax eliminates certain types of business and distorts or re-channels other types to the long-run detriment of the growth in the economy of the Province of Ontario.

During the past decade there have been many major changes in the investment business. The Investment Dealers' Association of Canada believes that the changes that have occurred in the investment industry urgently require either that the Security Transfer Tax Act be rescinded or that certain revisions are made in the Act so that the business of the investment dealer and broker in Ontario is not unnecessarily impeded or subjected to taxes on transactions which may not have been contemplated by those who framed the Act.

The areas to which we have particular reference are, the inception of the Money Market, the introduction of Electronic Data Processing and centralized Accounting, the change in financing Municipal obligations, the great increase in the number of inter-dealer transactions and the increased volume between the markets in Montreal and Toronto which give rise to double taxation. These factors have increased the incidence of security tax in our industry to the point where Security Transfer Tax can become a factor in determining whether or not a transaction will take place in the Province of Ontario.

Explanation of the Problems

I Money Market

One of the major changes in the security business during the past few years has been the development of the money market which now consists of trading in Canada and Provincial Treasury Bills, Government of Canada obligations maturing within three years, Municipal Short Term Notes and Short Term Commercial Paper in the form of bankers acceptance bills and promissory notes. The dealers have entered this market at the request of the Bank of Canada. With the exception of Government obligations, the instruments dealt with in the Short Term Money Market are more properly described as bills of exchange rather than as securities.

A serious impediment to the development of a broader short term money market in Ontario is the present uncertainty as to what constitutes a security under the Security Transfer Tax Act. The section of the Act (1b) defining security refers to shares of capital stock, debenture stock and any bond or debenture and does not further define bond or debenture. Current interpretation of the Act treats interest bearing promissory notes as securities and therefore taxable while it exempts non-interest bearing notes which are issued at a discount. As a direct result, interest bearing notes are dealt with only on a first issue agency basis and there is practically no after market for this type of money market instrument. If these were traded transfer tax would be exigible at 3¢ per $100 as against the dealers' normal spread of 1¢ to 2¢ per $100 per month. If a note had only 90 days to run to maturity the transfer tax payable would equal the dealers' spread. Most notes traded in the market are 30 to 90 day maturities. This state of affairs is viewed as a serious impediment to the development of a broader and more sophisticated "paper market" in Ontario. It would be inconsistent with current efforts directed towards improving the competitive position of industry in the Province to maintain this deterrent to the most efficent employment of temporary cash balances. It is recommended that this impediment be removed by either:

(1) amending the Act to specifically exempt all Money Market obligations having a maturity of one year or less or

(2) a further departmental ruling to the effect that interest bearing promissory notes issued for a term of one year or less are not securities within the meaning of the Act.

II Electronic Data Processing - Centralized Accounting

Another recent development in the investment business has been the development of centralized accounting due to the savings in time and labour that can be effected through the use of Electronic Data Processing equipment.

Prior to centralizing accounting in Ontario non-resident branch transactions were confirmed directly from the branch making the trade, blotters were maintained in the branch concerned and the Ontario Government did not tax the sale. With the introduction of punch card accounting it became essential in the interest of efficiency to process and mail all confirmations from the centralized accounting base in Ontario. This resulted in transactions made by the branch offices, which were confirmed through a centralized bookkeeping system, being subjected to Ontario Security Transfer Tax even though the transaction was arranged, paid for and delivered outside the Province of Ontario. The Association appreciates the co-operation of the Security Transfer Tax Department who have agreed that providing certain specific information is shown on each contract, trades of branches outside Ontario need not be subjected to Ontario Tax. The suggested procedure, however, is costly and complicates the channelling of day to day business.

The Association has also received many complaints from Ontario brokers and dealers who feel they are being unduly penalized on "funnelled" sales. A "funnelled" sale is an order resulting in a transaction between two non-residents which order is taken outside of Ontario and which transaction is consummated outside of Ontario. However, because dealers with Ontario head offices prepare and mail the confirmation of the transaction in Ontario they are subject to tax. Such taxes are an unfair result of utilizing centralized accounting techniques in Ontario.

The Association objects to the taxing of transactions of this type for the following reasons:

1. The change in ownership takes place outside of Ontario.

2. Non-residents may avoid the tax by transacting their business outside Ontario to the detriment of Ontario dealers.

3. The Ontario Tax is invariably absorbed by the Ontario dealer or broker as non-resident clients object strenuously to paying a tax when they know the transaction can be effected outside of Ontario and not subjected to tax.

III. Municipal Obligations

Under Section 5a (i) of the Security Transfer Tax Act transactions in bonds and debentures issued by or guaranteed as to principal and interest by Canada or any province of Canada or any municipality or school board in Ontario are not subject to the tax imposed by this Act.

The major change that has occurred in Municipal financing in Canada has been the introduction of the Ontario Municipal Improvement Corporation, The Alberta Municipal Financing Corporation and the increased use of provincial guarantees of municipal and school board issues by the other provinces, notably, British Columbia, New Brunswick, Newfoundland and Prince Edward Island. As a result an inequality exists in that issues by municipalities and school boards situated in provinces that do not guarantee these securities are subjected to tax if traded in Ontario while a like security bearing a provincial guarantee is exempted from tax.

It is submitted that this inequality should be removed by broadening the exemption so that all securities issued or guaranteed by the various public authorities at the three levels of government be given complete exemption.

Digitized by the Internet Archive
in 2025 with funding from
University of Toronto

https://archive.org/details/submissionstaxat068onta

IV Inter-Dealer Transactions

We believe the original concept of the Security Transfer Tax was a single levy on the change of ownership of bonds and stocks subsequent to their original issue to the investor. The sale of a security by the issuer to the investor or by one investor to another investor, however, does not in practice usually take the form of a direct sale from one to another unless the transaction is in a listed stock executed on a Stock Exchange. The principal functions of an investment dealer are the underwriting of new issues of securities and trading in outstanding securities. Through his trading activities the dealer establishes and maintains markets and thus provides liquidity and establishes value levels for securities not listed on exchanges. In carrying out these functions which are usually conducted as a principal the investment dealer is continually subjected to transfer taxes.

In the case of the primary distribution of a new issue of a security to the public the distributing machinery generally employed by an underwriter consists of the formation of banking and selling groups of dealers. This gives rise to multiple transfer taxes being first charged on any change of ownership within the groups and second on sales by each firm to the ultimate investor. In the case of the subsequent sale of a security by an investor it frequently happens that the security may pass through the hands of two, three or even more dealers before finding its way into the hands of another investor. Each dealer, acting as a principal, is subject to the payment of a transfer tax and it is not unusual for two, three or even more taxes to be collected on a single transfer of ownership from one investor to another. It is interesting to note that subject to certain regulations United Kingdom dealers are relieved from security transfer tax on transactions of this nature.

The imposition of transfer taxes on inter-dealer transactions is in effect a turnover tax on the dealers inventory. From the investment dealers' point of view this represents a heavy, unjust and probably an unintended tax burden.

V Double Taxation

The stock markets in Canada have become increasingly fluid in recent years, through improvements in communications, increased investor interest and the participation in Canadian investments by foreign professional investors.

As a result, clients expect, and professional ethics require, that when a broker has access to the facilities of the two principal exchanges in Canada that an order from a client be completed on the exchange offering the best market at the time to the client.

A trade on the exchange in Montreal completed for a resident of Ontario or a non-resident of Ontario who maintains his account with an Ontario broker is subject to tax in both provinces. It is not always possible or feasible for the dealer to collect both taxes in which case the dealer must absorb one tax.

We submit that the application of double taxation on the natural flow of investment funds within the country constitutes an unnecessary burden on the investor and inhibits the establishment of national markets.

Conclusion

It is concluded that the investment industry has experienced such growth and change in the past ten years that the Security Transfer Tax Act has become anachronistic. This Act has had no major revision in over 20 years. There is no indication that it was the intention of the Act to tax the type of transactions referred to above or to penalize Ontario dealers for more efficient business practices. The fact that these developments could not have been and were not foreseen has resulted in the interpretation and administration of the Act becoming extremely difficult. Decisions are necessarily made on an ad hoc basis which can lead to inequities despite the fact that those administering the Act do attempt to be fair and reasonable.

The Investment Dealers' Association of Canada believes that the Security Transfer Tax is an inequitable and costly nuisance. In its present form it fetters certain investment activities which would contribute to the growth of the Province and yet it produces only a small return.

We request that the Ontario Committee on Taxation consider recommending that the Security Transfer Tax be abolished.

All of which is respectfully submitted on behalf of The Investment Dealers' Association of Canada.

H. L. Gassard,
Managing Director.